

Cutting Carbon

What the rush to divest fossil fuels means for emissions reduction and engagement

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About ACCR

The Australasian Centre for Corporate Responsibility (ACCR) is a not-for-profit association that promotes responsible investment through undertaking and publishing research to evaluate and improve the performance of Australian listed companies on environmental, social and governance (ESG) issues. We have a small portfolio of shares that we hold for the purpose of engaging with listed companies, including through the filing of shareholder proposals.

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1. Executive summary

Throughout 2020, several major Australian investors committed to significantly decarbonise their portfolios, including by setting net-zero targets for 2050. Various asset owners and investment managers are debating the merits of different methods of achieving those targets, from investment in low- or zero-carbon technologies, to forceful stewardship with investee companies, to substantial capital reallocation and outright divestment. Previously, divestment from fossil fuels may have been viewed by some as a consideration for boutique ethical investors alone. Yet recent announcements indicate major investors have already begun divesting—a trend which is likely to continue.

This report focuses on the decarbonisation of listed equity portfolios in Australia. We outline current investor initiatives and commitments to support decarbonisation and energy transition. We explore the use of carbon exposure metrics to manage transition risk. We then consider the 25 largest emitting companies in the S&P/ASX200 index: their disclosure of carbon emissions, and their short-, medium- and long-term emissions reduction targets. The report concludes with an analysis of what investor commitments may mean for engagement with investee companies.

We consider that both engagement and divestment strategies will need to be deployed by active owners and managers in a rapidly shifting world, complemented by reinvestment in climate solutions. While we do not seek to reprise the debate between engagement and divestment through this report, we do highlight the issues with decarbonising listed equity portfolios by focusing on carbon exposure metrics alone, we find that:

- Some investor initiatives are actively recommending divestment from, at least, distressed sectors of the coal, oil and gas industries;
- Several Australian investors have made commitments that imply immediate or imminent divestment from some fossil fuels;
- Carbon exposure metrics are an imperfect tool to measure climate risk, much less to base targets on;
- Disclosure of carbon exposure metrics across Australian superannuation funds is limited and inconsistent, preventing meaningful comparison between funds;
- Most of the companies responsible for the majority of the emissions in the benchmark S&P/ASX200 index are yet to commit to substantive emissions reduction targets by 2030;
- There is a lack of clarity in investor commitments to date about the implications for divestment and engagement with investee companies.

Institutional investors have an enormous role to play in tackling the climate crisis, given their access to the tools of shareholder-company engagement, through which it is possible to exert sector-, economy- and world-wide influence. While numerous investors' divestment announcements in 2020 may protect members in those funds from some climate-related risk, they must be complemented with

a suite of other measures. Above all, forceful, outcomes-focused engagement in companies in which they remain invested and a clear path of escalation, with transparent signposting of actions and decision points.

Alongside public divestment actions, it is increasingly urgent that investors be accountable to their members and peers about the tools they are committed to using to engage with investee companies. This should also involve speaking clearly about the tools of engagement that are not being used.

Private meetings, during which company commitments are negotiated, are still the market standard approach to company engagement by investors, worldwide. In most markets, we are seeing increasing support for, and the occasional filing of, shareholder resolutions by institutional investors. However, coordinated attempts at board renewal, strongly contested public discussions about company strategy including red-lining projects or asset level wind-down, and legal avenues available to shareholders, are rarely deployed.

The deployment, in combination, of non-exhaustive approaches to engagement followed by divestment undersells the power and responsibility of the investment sector in addressing the climate crisis.

2. Recommendations

ACCR welcomes recent commitments to decarbonisation by several Australian investors. In order for these commitments to translate to a decline in emissions in the real economy, something which is urgently needed, we have three key recommendations for the sector.

Recommendation 1: The scope and detail of portfolio decarbonisation must be transparent

The current patchwork of voluntary declarations makes meaningful comparison between funds impossible, and is easily misinterpreted by clients and beneficiaries. Therefore:

- Calculation of portfolio exposure to heavy emitting companies must be consistent and publicly available for all superannuation funds.
- When divestment is the primary approach through which portfolio decarbonisation is pursued, it should be named as such, alongside the implications (or lack thereof) for immediate emissions reductions in the real economy.
- Long-term net-zero portfolio targets must be supported by short- and medium-term targets.

Recommendation 2: Forceful engagement

Portfolio decarbonisation must include forceful engagement with high-emitting companies. Investors should provide a clear map of options for escalation, and a timeline for when they are willing to employ the full range of available engagement tools. These include (as outlined by the Net Zero Asset Owners' Alliance):¹

- co-filing and/or supporting shareholder resolutions in support of decarbonisation strategies;
- voting against directors, remuneration or annual reports;
- voting against Mergers & Acquisitions (M&A); and
- divestment.

Recommendation 3: Investment in climate solutions

Institutional investors must be prepared to allocate capital to climate solutions, from renewable energy to energy efficiency and emerging technologies. It is particularly important that capital divested from fossil fuels or emissions intensive companies is redirected to climate solutions.

¹ The Institutional Investors Group on Climate Change, "Net Zero Investment Framework for Consultation", August 2020, p28.

3. Why climate matters to investors

Institutional investors are becoming increasingly attuned to the serious risks posed by climate change. The classification of these risks varies somewhat between analyses.² Most separate out the most straightforward and easy to grasp category: physical risks to assets from climate change. In the context of increasingly frequent and severe extreme weather events, even non-specialist investors are becoming aware of the highly visible risks to investments across a variety of sectors. Insurers face soaring costs of payouts in the wake of hurricanes; electricity providers are being forced to replace swathes of power lines destroyed by bushfire; real estate asset owners are being hit with lengthy rebuilding periods where they cannot receive rental income.³ Investors are increasingly looking to companies to account for the material risks of climate change to physical assets, operations and, ultimately, returns.

The second group of risks arises from a more complex series of factors, which are particularly acute for investors in heavy emitting companies. The first is transition risk: that sudden, dramatic and/or uneven shifts away from fossil fuelled economic activity will render particular assets—and sometimes whole companies and sectors—dramatically less profitable. The potential for assets to become “stranded” in a zero-carbon future is a topic of deep concern for investors,⁴ who look also to risks posed by fast-developing regulatory and policy change, under both national legislative regimes and international agreements. Activity in this arena intensified in 2020, with several national governments making commitments to net-zero emissions, exploring options for intervention such as carbon tariffs, and the US president-elect promising the country’s return to the Paris Agreement.

The Principles for Responsible Investment’s Inevitable Policy Response (IPR) forecasts “a response by 2025 that will be forceful, abrupt, and disorderly”⁵ because of the delays to date in responding to climate change. The IPR suggests that it is no longer a matter of *if* governments take action, but *when* they take action. Any large scale government intervention to address carbon emissions is likely to have a significant impact on companies that are yet to commit to ambitious emissions reduction pathways.

Emissions-intensive industries also face increasing reputational risk, as companies receive heavier public scrutiny and criticism.⁶ Though the COVID-19 pandemic has changed the landscape of public

² International Finance Corporation, “Account for Climate Risk” (website), accessed 27 November 2020; World Resources Institute and Ceres, “Questions and Answers for Investors on Climate Risk”, Investor Network on Climate Risk Research Consortium, December 2004; <https://www.fsb-tcfd.org/about/>, accessed 27 November 2020.

³ Ausnet Services, “Ausnet Annual Report 2020”, May 2020; IBISWorld, “2019-20 Australian Bushfire Crisis: The Economic Impact”, March 2020.

⁴ Carbon Tracker, “Unburnable Carbon: Australia’s Carbon Bubble”, December 2013.

⁵ <https://www.unpri.org/inevitable-policy-response/what-is-the-inevitable-policy-response/4787.article>, accessed 23 December 2020.

⁶ EY, “Climate Change: The Investment Perspective”, 2016.

advocacy, public concern around climate change has not receded. Heavy emitters face continual pressure, particularly in the context of proposals for large government bailouts and stimulus packages.

Finally, the threat to portfolio returns from ‘systemic risk’—system-wide macroeconomic damage resulting from climate change and related upheaval—is becoming more widely recognised.⁷ Australian regulators have acknowledged as much,⁸ pushing companies to adopt more rigorous disclosure of their exposure to various eventualities. Recent studies have foreshadowed widespread future negative economic impacts in Australia of a failure to act decisively on climate change: the Australia Institute estimated the potential cost at \$131 billion dollars per year,⁹ while Deloitte Access Economics estimated a total of \$3.4 trillion in GDP losses by 2070.¹⁰

The growing salience of these risks has impelled investors to explore opportunities to drive emissions reductions, resulting in the proliferation of investor climate networks including the Ceres Investor Network, Climate Action 100+, The Investor Agenda, Climate League 2030, the Global Investor Coalition on Climate Change, the Investor Group on Climate Change (IGCC), the Institutional Investors Group on Climate Change (IIGCC), and the UN-convened Net-zero Asset Owner Alliance (recent consultations by the latter two will be examined in more detail below). In the last month of 2020, two new initiatives were announced: the Net Zero Asset Managers Initiative and the Net Zero Underwriters Alliance.

⁷ Commissioner Rostin Behnam and Bob Litterman, “Managing Climate Risk in the U.S. Financial System”, n.d., p196; Barnali Choudhury, “Climate Change as Systemic Risk”, SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, October 2020); Veena Ramani, “Addressing Climate as a Systemic Risk: A Call to Action for Financial Regulators”, *The Harvard Law School Forum on Corporate Governance* (blog), June 2020; Teresa Johnson, “Treat Climate Change as a Systemic Risk to Global Finance”, *Financial Times*, March 2020.

⁸ James Fernyhough, “ASIC Names Climate Change ‘Systemic Risk’ in Rulebook”, *Australian Financial Review*, August 2019.

⁹ Tom Swann et al., “Cold Shower on Economics of Global Warming”, The Australia Institute, April 2019, p1.

¹⁰ Deloitte Access Economics, “A New Choice: Australia’s Climate for Growth”, November 2020, p5.

4. Australia's emissions performance

Australia's emissions performance has been steadily out of step with efforts to secure a safe climate. As a leading exporter of fossil fuels, the country's largest contribution to carbon pollution is the burning (overseas) of coal, oil and gas extracted in Australian territory.¹¹ Nonetheless, the carbon pollution resulting from economic activity within Australian borders is significant and is the subject of a mandated reduction under the Paris Agreement. These emissions have remained on a trajectory far from what is needed to limit global warming to 1.5°C.

Various analyses have consistently drawn attention to the stubbornly high rate of Australian carbon pollution,¹² which must fall sharply to meet Australia's commitments under the Paris Agreement.¹³ Even the unexpected decline in emissions-producing economic activity over the past year, related to the COVID-19 pandemic, has not been sufficient to bring Australia's carbon pollution down in line with a trajectory that will meet its Paris obligations.¹⁴

Australian climate policy has vacillated in recent years, in no small part due to the efforts of lobby groups seeking to weaken regulation of carbon pollution.¹⁵ This has allowed a small number of large companies—particularly in fossil fuel intensive industries—to continue with heavily carbon polluting activities.¹⁶

The trajectory of sectoral carbon emissions in Australia is charted below in Figure 1. Over the last decade, emissions from electricity—by far the most significant source of carbon pollution in Australia—have declined significantly due to the rapid growth of renewable energy generation. Nonetheless, they are still much higher in aggregate terms than they were in 1990. Emissions from mining have dramatically increased since 2015, largely attributable to the expansion of the Australian LNG industry.¹⁷

¹¹ Tom Swann, "High Carbon from a Land Down Under", The Australia Institute, July 2019.

¹² International Monetary Fund, *Fiscal Monitor: How to Mitigate Climate Change*, October 2019; <https://climateactiontracker.org/countries/australia>, accessed 26 November 2020; "Tracking 2 Degrees", *Ndevr Environmental Consulting* (blog), accessed 26 November 2020.

¹³ Mike Foley, "Australia's Emissions Reductions Falling Short of Climate Commitment", *The Sydney Morning Herald*, May 2020.

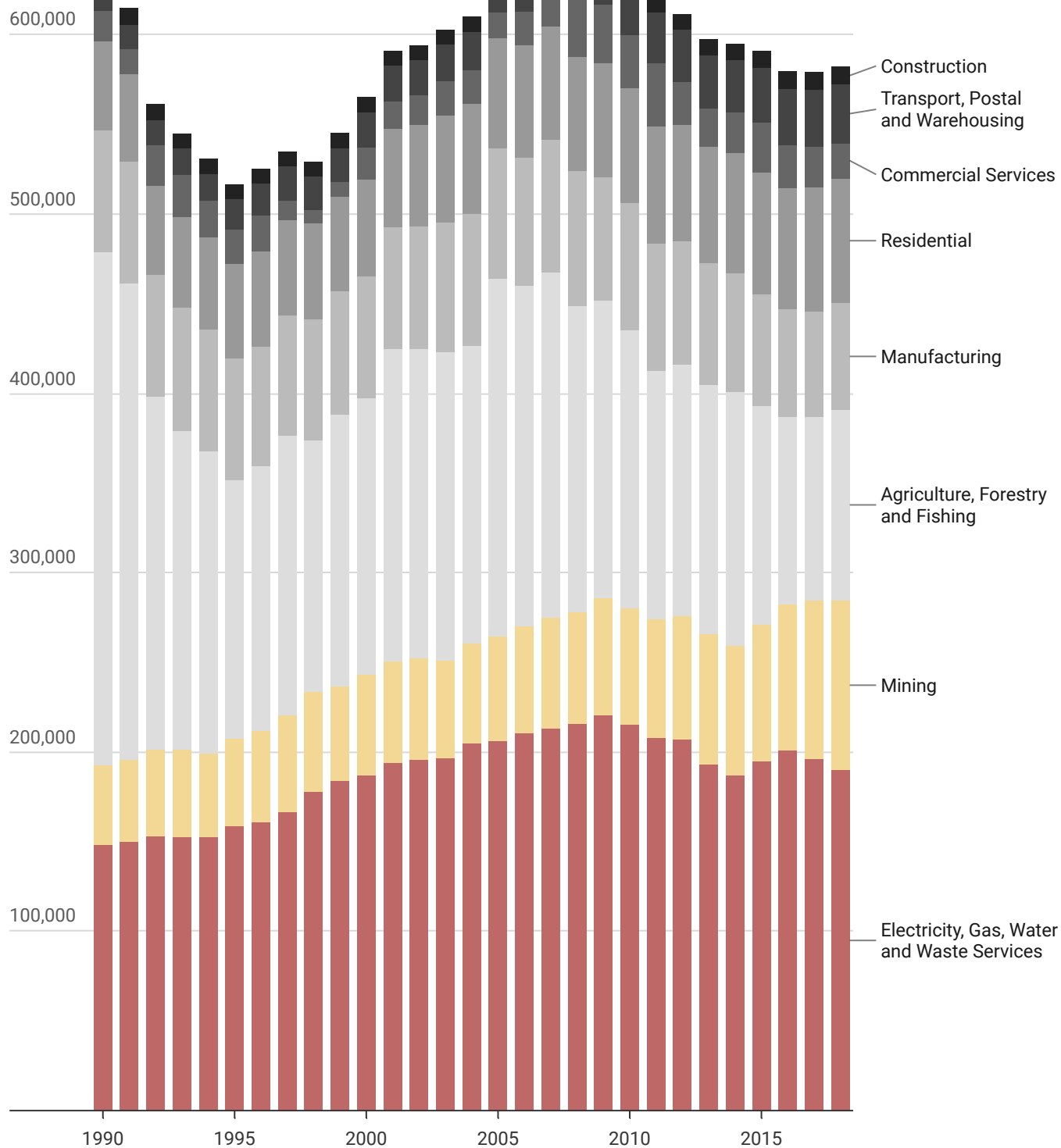
¹⁴ Nick O'Malley, "Australian Emissions Break Paris Targets Even after Corona Quiet", *The Sydney Morning Herald*, June 2020.

¹⁵ InfluenceMap, "Australian Industry Associations and Their Carbon Policy Footprint", September 2020.

¹⁶ Clean Energy Regulator, "Australia's 10 Highest Greenhouse Gas Emitters 2018-19", (website) accessed 26 November 2020.

¹⁷ "Quarterly Update of Australia's National Greenhouse Gas Inventory: March 2020", August 2020, p9.

Figure 1: Sectoral emissions performance in Australia, 1990-2018 (tonnes CO₂-e)



Source: Department of Industry, Science, Energy and Resources, "National Greenhouse Gas Inventory by Economic Sector: 2018 Data Tables", May 2020.

5. Investor commitments

5.1 Collaborative initiatives

Investor climate networks established with the stated purpose of supporting decarbonisation and energy transition have proliferated in the last decade. Two documents recently released for consultation by collaborative investor initiatives make strong efforts to define the methodology and mechanics of portfolio decarbonisation, and suggest how divestment and reallocation efforts relate to engagement strategies:

- the *Net Zero Investment Framework for Consultation*, developed by Europe-based Institutional Investor Group on Climate Change (IIGCC); and
- the *Draft 2025 Target Setting Protocol*, developed by the UN-convened Net-Zero Asset Owner Alliance (NZAOA).

These two documents give a sense of emerging shared goals and engagement standards around which the global investment community may coalesce. Interestingly, each of these documents raises, if delicately, the potential pitfalls of a portfolio decarbonisation strategy overly reliant on divestment and reallocation. This discussion is welcome, and will become increasingly important.

Net Zero Investment Framework (Framework)

The Net Zero Investment Framework includes a series of minimum fund-level governance and strategy standards for investors to become “Paris-aligned,” focused on fund commitments, undertaking TCFD-style risk assessment and reporting, and engaging asset managers in decarbonisation strategy.¹⁸

The Framework’s recommended approach to developing decarbonisation strategies for listed equities recommends investors assess and categorise each company across a spectrum according to the potential of the business to decarbonise (over an indefinite term).¹⁹ The highest category is “**Achieving net-zero**”²⁰ followed by “**Aligned to a net-zero pathway**”, “**Has potential to transition**”, and “not aligned or has **low potential to transition**.”

¹⁸ The Institutional Investors Group on Climate Change, “Net Zero Investment Framework for Consultation”, August 2020, p11.

¹⁹ *ibid.*, p24.

²⁰ The preliminary framework discourages the use of offsets as a primary tool for decarbonisation at the portfolio level “except where there is no technologically or financially viable solution.” (*ibid.*, p37.) It does not include definitions for “technologically or financially viable”, and does not specify metrics for an appropriate level of emissions reductions through offsetting.

The Framework emphasises investor engagement with companies, particularly in the “aligned” and “has potential” categories, as the primary strategy to achieve emissions reductions. The Framework advocates for investors to use a range of engagement tools, including:²¹

- voting against the board, remuneration policy or annual report and accounts if a company is not on track to achieve its plan and targets for a period of two or more years;
- voting against Mergers & Acquisitions (M&A) unless the post-M&A company meets or can be expected to meet those targets within a reasonable period; and
- co-filing and/or supporting shareholder resolutions.

This is an important contribution to deepening the conversation on engagement tools beyond private meetings and voting on shareholder resolutions.

The Framework concedes that divestment may become a necessary tool in certain circumstances, which it articulates as:²²

- when scenario analysis aligned with 1.5°C warming identifies unacceptable climate financial risks;
- when a company’s primary activity is no longer considered permissible within a credible pathway towards global net-zero emissions (IIGCC cites thermal coal and tar sands as examples); and/or
- in selective cases as an escalation measure, following engagement (though the criteria and timeline for this remain unclear).

The Framework emphasises a holistic, portfolio-level approach to decarbonisation,²³ with a focus on setting specific targets in relation to emissions intensity reduction, absolute reductions and the allocation of capital to climate solutions.²⁴ It also proposes that at least 70-90% of emissions from material sectors²⁵ be either aligned to a net-zero pathway, or the subject of direct or collective engagement.

Draft 2025 Target Setting Protocol (Draft Protocol)

The Net-Zero Asset Owner Alliance (NZAOA) commits all members to net-zero portfolios by 2050.²⁶ Members are expected to extend their commitments to all assets under management, except money

²¹ *ibid.*, p28.

²² *ibid.*, p29.

²³ *ibid.*, p12-13.

²⁴ “This should be based on the EU taxonomy mitigation criteria to the extent possible.” (*ibid.*, p12.).

²⁵ “As a guide, PAII proposes ‘material’ sectors to be those in NACE code categories: A-H and J-L.” (*ibid.*, p24.).

²⁶ <https://www.unepfi.org/net-zero-alliance/>, accessed 29 November 2020.

managed by group-owned asset managers for third party clients. As at the close of 2020, Cbus and QBE Insurance Group are the only two Australian members of the Alliance.²⁷

Throughout October to November 2020, NZAOA opened the Draft 2025 Target Setting Protocol for stakeholder consultation. The Draft Protocol details more specific proposals for interim actions by its members.

The Draft Protocol proposes that all members reduce the Scope 1 and 2 emissions in their portfolio (excluding sovereign debt, for now) between 16% and 29% by 2025, with a baseline year of 2019.²⁸ According to the Draft Protocol, NZAOA members should track Scope 3 emissions in their portfolio, but are explicitly discouraged from setting Scope 3 targets “until data becomes more reliable.”²⁹ Scope 3 intensity targets for priority sectors (oil and gas, utilities, steel, transport) are encouraged, but specific expectations for these sector targets are not quantified.³⁰

A potential weakness in the Draft Protocol is its non-committal language on emissions target setting: the NZAOA accepts intensity targets set by members for their corporate debt and equity portfolios, though absolute targets are “preferred.” Reporting both absolute and intensity-based targets is “encouraged,” and the document notes that “if an intensity-based metric is utilised then an explanation should be included.”³¹ While some flexibility is appropriate, members and stakeholders would benefit from clearer, more definitive guidance and an approach that promotes standardisation of conduct and reporting.

The Draft Protocol’s acknowledgement of the importance of engagement with companies is welcome. It recommends that all members set engagement targets, using a priority sector-level approach, or the member portfolio’s top 20 (non-aligned) emitters, or those responsible for 65% of emissions in the member’s portfolio. However, the Alliance “does not prescribe a modus operandi for member’s engagement” and only “[seeks] to remain aligned with [the] PRI reporting framework for accounting on engagement activities.”³² The final version of the Draft Protocol would benefit from a greater level of detail about NZAOA’s expectations of the engagement and escalation activities of its members.

The Draft Protocol’s suggested agenda for engagement with governments is more precise. Its contribution to the public policy agenda highlights the importance of embedding net-zero by 2050 in the economic recovery from the COVID-19 pandemic at a national level, and makes specific recommendations on, inter alia the elimination of fossil fuel subsidies, halting deforestation, and

²⁷ UNEP Finance Initiative, “UN-Convened Net-Zero Asset Owner Alliance Adds Members Managing Combined \$200 Billion Assets”, November 2020.

²⁸ U.N.-convened Net-Zero Asset Owner Alliance, “Draft 2025 Target Setting Protocol”, October 2020, p8.

²⁹ *ibid.*, p7.

³⁰ *ibid.*, p8.

³¹ *ibid.*, p31.

³² *ibid.*, p50.

ensuring investment in low-emissions infrastructure.³³ These would be powerful positions for asset owners to support.

5.2 Investor commitments to net-zero in the Australian market

In September 2020, the Australia-based Investor Group on Climate Change (IGCC) published a survey of 38 of its members that concluded that net-zero commitments were becoming normalised, but further action was required to match action with aspirations.³⁴

During 2020, several Australian investors made commitments to net-zero emissions in their investment portfolios by 2050, including AustralianSuper, Aware Super, Cbus, HESTA, IFM Investors, Macquarie Asset Management and UniSuper. Local Government Super made this commitment in 2019. In some cases, these longer-term commitments have been accompanied by short- or medium-term commitments to reduce the carbon exposure or emissions intensity of listed equities portfolios. Some investors have explicitly divested from companies involved in thermal coal mining in 2020, including Aware Super, HESTA and UniSuper.

Prior to 2020, only a handful of investors had divested from companies materially involved in thermal coal mining across their entire portfolios, rather than in a single investment fund or option. Australian Ethical never invested in coal or oil, and divested from unconventional gas in 2011 and conventional gas in 2016.³⁵ UCA Funds Management (now UEthical) divested from “dirtier or riskier” fossil fuels in 2014,³⁶ and all fossil fuels in 2019.³⁷ Local Government Super divested from companies with a material interest in the thermal coal supply chain in 2014.³⁸ Future Super was established as a “fossil fuel free” fund in 2014.³⁹ Vision Super divested from thermal coal and tar sands, and switched to a low carbon benchmark in 2018.⁴⁰ NGS Super divested from thermal coal in 2018.⁴¹

Numerous other investors previously limited their divestment from fossil fuels to a single fund or investment option, which typically represented a relatively minor percentage of assets under management. We will look at four of the latest commitments in detail.

³³ *ibid.*, pp55–56.

³⁴ Investor Group on Climate Change (IGCC), “2020 Net Zero Investment Survey”, September 2020.

³⁵ <https://www.australianethical.com.au/blog/investing-in-a-fossil-fuel-free-future/>, accessed 23 December 2020.

³⁶ Deborah Gough, “Uniting Church to dump fossil fuel corporation investment”, *The Sydney Morning Herald*, August 2014.

³⁷ <https://www.ueethical.com/blog/u-ethical-divests-from-fossil-fuels>, accessed 23 December 2020.

³⁸ Jamie Smyth, “Australian pension fund LGS drops coal assets”, *Financial Times*, October 2014.

³⁹ <https://www.futuresuper.com.au/about-us>, accessed 23 December 2020.

⁴⁰ Anastasia Santoreneos, “Vision Super goes green”, *Money Management*, November 2018.

⁴¹ <https://www.ngssuper.com.au/investments/fund-sustainability/active-ownership-and-engagement>, accessed 23 December 2020.

Aware Super

In July 2020, superannuation fund Aware Super announced its Climate Change Portfolio Transition Plan (‘Transition Plan’), which commits the fund to transition its portfolio to net-zero emissions by 2050.⁴²

The Transition Plan is ‘three-pronged’, covering low carbon investment, portfolio future-proofing, and engagement.⁴³ Firstly, the fund has pledged to reduce the emissions of its listed equities portfolio by a minimum of 30 per cent by 2023. In October 2020, the fund passively excluded high emitting companies, enabling it to effectively reduce the carbon footprint of its equity holdings by 40 per cent, and exceed its 2023 target “virtually overnight”.⁴⁴ Secondly, Aware Super committed to advocate for a 45 per cent reduction in carbon pollution across the national economy by 2030, and to assess the need to divest from different sectors of the economy and specific companies accordingly. Finally, the fund committed to continuing to work both independently and alongside industry policy and advocacy groups on company engagement to achieve its short-, medium- and long-term emissions targets.

Cbus

Superannuation fund Cbus was the first Australian asset owner to become a member of the Net-Zero Asset Owner Alliance.⁴⁵ In August 2020, Cbus announced its Climate Change Roadmap.⁴⁶ This included a target of cutting Scope 1 and 2 emissions of the fund’s entire investment portfolio by 45 per cent by 2030, and achieving net-zero emissions by 2050.

In the Climate Change Roadmap (‘Roadmap’), Cbus proposed to identify the carbon emissions associated with its investments, acknowledging that many assets will be unable to transition to net-zero and will not see out their economic life. The Roadmap set targets and established decarbonisation pathways for each class of assets, on the premise that different sectors of the economy will decarbonise at different rates. The Roadmap seeks to develop a “stranded assets framework” to identify and potentially exclude investments at risk of being unable to transition.⁴⁷ These assets would likely include some coal mines and coal-fired power stations. However, unlike HESTA and Aware Super, Cbus has stated that divestment from fossil fuels will not be an explicit part of its strategy to decarbonise. Instead, Cbus has committed to apply pressure to the companies it holds by demanding climate risk reporting in line with the TCFD.

⁴² <https://aware.com.au/blog/divesting-from-thermal-coal.html>, accessed 27 November 2020.

⁴³ Aware Super, “Our Approach to Climate Change”, November 2019.

⁴⁴ James Fernyhough, “Aware Super Nearly Halves Emissions in Mass Divestment”, *Australian Financial Review*, November 2020.

⁴⁵ UNEP-Finance Initiative, “Cbus Is First Australian Member of UN-Convened Net-Zero Asset Owner Alliance”, *United Nations Environment Programme - Finance Initiative* (blog), August 2020.

⁴⁶ Cbus, “Cbus Sets Strong 2030 Target in Revamped Climate Road Map”, September 2020.

⁴⁷ Cbus, “Cbus Climate Change Roadmap: Beyond 2020”, August 2020.

HESTA

In June 2020, superannuation fund HESTA announced a commitment to reduce the absolute carbon emissions of its investment portfolio by 33 per cent by 2030, and then to net-zero by 2050.⁴⁸ This was the first announcement setting both absolute emissions reduction and net-zero targets by a large (>\$20 billion) Australian superannuation fund, establishing an important precedent for the sector.

HESTA's announcement pledged a Climate Change Transition Plan (CCTP) which would be the "most comprehensive of its kind undertaken by a superannuation fund."⁴⁹ HESTA has promised that the CCTP, which has not yet been published, will introduce carbon reduction targets for the portfolio, outline engagement strategies with asset managers, and align the fund's investment portfolio to the Paris Agreement.

In 2014, HESTA announced that it would make no new investments in thermal coal companies (defined as companies that generate at least 15 per cent of revenue from exploration, production or the transportation of thermal coal).⁵⁰ Nevertheless, this policy allowed the fund to retain its existing investments in those companies.

By contrast, HESTA's new climate policy, announced in June 2020, applies this exclusion strategy to all thermal coal companies, indicating that the fund will completely divest from thermal coal. When the policy was announced, HESTA's CEO Debby Blakey stated there was no immediate plan to divest from other fossil fuels. Instead, she said, the fund will pressure companies to reduce their emissions gradually to ensure an "orderly transition" to net-zero.⁵¹

IFM Investors

In October 2020, asset manager IFM Investors committed to net-zero emissions by 2050 across all asset classes, aligned with the goals of the Paris Agreement.⁵² IFM had previously announced the Australian Infrastructure Carbon Reduction Initiative in August 2019, which focused on reducing material Scope 1 and 2 emissions in seven infrastructure assets, which together accounted for more than 90% of the carbon emissions in the fund's portfolio.⁵³ This initiative included short- to mid-term emissions reduction targets.

IFM has established a multi-disciplinary taskforce within its investment team to work on achieving the net-zero target. The fund plans to establish more granular emissions reduction commitments, identify

⁴⁸ HESTA, "HESTA Announces Net Zero by 2050 Aim as Part of Ambitious Climate Change Plan", June 2020.

⁴⁹ *ibid.*

⁵⁰ HESTA, "HESTA Announces New Restriction on Thermal Coal Investments", September 2014.

⁵¹ James Fernyhough, "HESTA Dumps Coal, Targets Absolute Net Zero", *Australian Financial Review*, June 2020.

⁵² IFM Investors, "IFM Investors Targets Net Zero by 2050", October 2020.

⁵³ IFM Investors, "Taking the Lead on Infrastructure Carbon Reduction in Australia", October 2019.

investment opportunities in decarbonisation and climate-resilient assets, and consider the “evolution of technologies and better understand the likely transition pathway”.⁵⁴

⁵⁴ IFM Investors, “IFM Investors Targets Net Zero by 2050”, October 2020.

6. Carbon exposure metrics

The net-zero frameworks discussed in the previous section and many of the commitments announced by institutional investors to date, include targets to reduce carbon exposure. This usually involves reducing investments (either in dollar or percentage terms) in companies with relatively higher carbon footprints or carbon intensity.

S&P Dow Jones Indices define and calculate four “carbon exposure metrics”⁵⁵ for its suite of indexes:

1. **Carbon Footprint (metric tonnes CO₂e/USD 1 million invested)**

The aggregation of operational and first-tier supply chain carbon footprints of index constituents per USD 1 million invested.

2. **Carbon Efficiency (metric tonnes CO₂e/USD 1 million revenues)**

The aggregation of operational and first-tier supply chain carbon footprints of index constituents per USD 1 million in revenue.

3. **Weighted Average Carbon Intensity (metric tonnes CO₂e/USD 1 million revenues)**

The weighted average of individual company intensities (operational and first-tier supply chain emissions over revenues), weighted by the proportion of each constituent in the index.

4. **Fossil Fuel Reserves (metric tonnes CO₂e/USD 1 million invested)**

The carbon footprint that would be generated if the proven and probable fossil fuel reserves owned by index constituents were burned per USD 1 million invested.

There does not appear to be a standard measure against which Australian investors report, despite the fact that these metrics have been in common use for several years.

Carbon footprint analysis became prominent in the investment sector after the founding of the Montreal Pledge,⁵⁶ a voluntary initiative launched in 2014 that encourages asset owners (such as superannuation funds) and investment managers to “measure, disclose and reduce their portfolio carbon footprints.” Australian signatories include Australian Ethical, HESTA, Catholic Super, Local Government Super, UCA Funds Management (now U Ethical), VicSuper (now part of Aware Super), Solaris Investment Management, Commonwealth Super Corporation and BT Financial Group. However, commitments to the Montreal Pledge appear to have waned in recent years, superseded by more comprehensive disclosure frameworks such as the Taskforce on Climate-related Financial Disclosures (TCFD).⁵⁷

⁵⁵ S&P Dow Jones Indices LLC, “Index Carbon Metrics Explained”, 2020, p6.

⁵⁶ www.montrealpledge.org, accessed 2 December 2020.

⁵⁷ <https://www.fsb-tcfd.org/about/>, accessed 2 December 2020.

Currently, within Australia’s superannuation sector, reporting of carbon exposure metrics is limited in several respects: the low number of funds disclosing; the variability of metrics used for disclosure; the infrequency of disclosures, and; the presentation of data.

Of the thirty largest superannuation funds, just eleven funds disclose any of the four carbon exposure metrics defined by S&P Dow Jones.

Of those eleven funds, only seven disclose the actual carbon exposure metric (which varies) of their portfolio, while the other four disclose a measure relative to their own benchmark. Catholic Super⁵⁸, Local Government Super⁵⁹ and Vision Super⁶⁰ disclose the most comprehensive suite of metrics. Australian Ethical⁶¹ also discloses the Weighted Average Carbon Intensity of its portfolio.

The Taskforce on Climate-related Financial Disclosures (TCFD) recommends that asset owners and asset managers “report to their beneficiaries and clients” the Weighted Average Carbon Intensity metric (metric tons CO₂e/USD 1 million revenues) and consider reporting other metrics.⁶² Weighted Average Carbon Intensity captures the relationship between carbon emissions and company revenue, which allows for greater comparability between companies and markets. It is also less volatile than the Carbon Footprint, which is based primarily on a company’s market value rather than its revenues.

Just six funds report Weighted Average Carbon Intensity: Australian Ethical, Catholic Super, Cbus, Local Government Super, Sunsuper and Vision Super. These metrics are displayed below, alongside various equity indexes. The lack of consistent metrics from superannuation funds and index providers is a problem that could be addressed through standardised, regular disclosure by all parties.

⁵⁸ MyLifeMyMoney Superannuation Fund, Carbon Footprint Summary 2020, November 2020, pp1-2.

⁵⁹ Local Government Super, “LGS Carbon Footprint Report”, June 2020, pp1-2.

⁶⁰ Vision Super, “Annual Report 2020”, October 2020, pp38-39.

⁶¹ <https://www.australianethical.com.au/personal/ethical-investing/our-approach/impact/#carbon-footprint>, accessed 2 December 2020.

⁶² Task Force on Climate-related Financial Disclosures, “Implementing the Recommendations of the Task Force on Climate Related Financial Disclosures”, June 2017, p42.

Table 1: Disclosed Weighted Average Carbon Intensity

Fund/Index	Weighted Average Carbon Intensity (tonnes of CO2/\$m sales)	Date
MSCI Emerging Markets	298.1	30 April 2020
S&P/ASX200	277.69	30 October 2020
Sunsuper	257 (benchmark=241)	30 June 2019
S&P 500	205.75	30 October 2020
Catholic Super	186.9 (benchmark=215.4)	30 June 2020
Cbus	174 (benchmark=199)	30 June 2020
MSCI ACWI	178.5	30 April 2020
MSCI World	162.4	30 April 2020
Local Government Super	113.3 (benchmark=162.3)	30 June 2020
Vision Super	102.4 (benchmark=164.1)	30 June 2020
MSCI ACWI Low Carbon Target	58.2	30 April 2020

Source: MSCI, S&P Dow Jones and fund reporting.

Note: Australian Ethical was excluded from this table, as it reports its Weighted Average Carbon Intensity in AUD.

Carbon footprint—the amount of carbon emissions per dollar invested—is also commonly disclosed by some superannuation funds. AustralianSuper, Colonial First State and UniSuper describe this metric as “carbon intensity”. This lack of common language is confusing for members but could be easily addressed through an industry standard.

Just five Australian superannuation funds report the actual carbon footprint of their listed equities portfolios: BT Financial Group, Commonwealth Super Corp, Local Government Super, Sunsuper and Vision Super. Another four funds report a relative figure, i.e. the relative difference between each of its investment options and the relevant benchmark, but not the actual carbon footprint: AustralianSuper, AMP, Aware Super and UniSuper. This lack of disclosure across the sector prevents meaningful comparison between funds.

Table 2: Disclosed carbon footprint

Fund/Index	Carbon to Value Invested (tonnes of CO2/\$1m invested)	Date
S&P Emerging Markets Core	267.65	30 October 2020
BT Financial Group (most options)	175-180	30 June 2020
S&P/ASX200	156.39	30 October 2020
Local Government Super (Australian Equities)	139.1 (benchmark=179.6)	30 June 2020
Sunsuper	135 (benchmark=110)	30 June 2019
MSCI ACWI	124.8	30 June 2020
Local Government Super (International Equities)	110.8 (benchmark=124.5)	30 June 2020
Commonwealth Super Corp	90 (benchmark=98)	31 December 2019
Vision Super	82.9 (benchmark=124.8)	30 June 2020
S&P 500	64.25	30 October 2020

Source: MSCI, S&P Dow Jones and fund reporting.

7. Cutting carbon

As discussed in Section 5, various collaborative initiatives encourage investors to set targets to reduce emissions in their investment portfolios. While such initiatives are a welcome and necessary step, reducing carbon exposure within a listed equities portfolio may not result in immediate emissions reductions in the real economy. In addition, such initiatives do not guarantee, and in some cases work against, forceful and exhaustive engagement with carbon intensive companies.

By reducing carbon exposure within a listed equities portfolio, investors aim to reduce their exposure to transition risk faced by the most carbon intensive companies. As the world shifts away from fossil fuels, companies responsible for producing or burning coal, oil and gas will become less valuable. However, transition risk is only one form of climate risk, and investors focused exclusively on reducing carbon exposure may overlook companies exposed to the fossil fuel supply chain (which are not necessarily carbon intensive), or companies exposed to the physical risks from climate change.

Further, reducing portfolio carbon exposure does not grapple directly with the systemic risks of climate related upheaval. To put it another way, not even a carbon free portfolio will guarantee strong returns in a scenario with extreme or runaway climate change. This is because reducing carbon exposure does not necessarily equate to reducing emissions in the real economy. This is acknowledged by the Net-Zero Asset Owners Alliance, which notes that the “decarbonisation of portfolios could be easily achieved by selling carbon intensive investments. However, it is highly questionable if such actions alone would have a positive impact on the real economy”.⁶³ Counter to this argument, divestment advocates have long contended that, at scale, divestment of fossil fuel companies will not only reduce the share price of those companies, but in the long run, increase their cost of capital, putting pressure in a material sense on projects on the margins of viability.⁶⁴ The DivestInvest initiative⁶⁵ encourages individuals and organisations to divest from fossil fuel companies and invest in climate solutions. This reinvestment of capital is intended to complete the act of divestment from fossil fuels, by achieving the aforementioned goals and encouraging those companies dedicated to reducing emissions.

According to MSCI, the Australian share market is one of the most carbon intensive indexes in developed markets.⁶⁶ Within the benchmark index S&P ASX/200, much of the carbon intensity is driven by a relatively small number of companies. As shown below, more than 80% of the Weighted Average Carbon Intensity of the S&P ASX/200 comes from just three sectors: Materials, Utilities and Energy.

⁶³ U.N.-convened Net-Zero Asset Owner Alliance, “Draft 2025 Target Setting Protocol”, October 2020, p24.

⁶⁴ David Macri, “Why divest from fossil fuels”, Australian Ethical (blog), 14 November 2019.

⁶⁵ <https://www.divestinvestaustralia.org.au/about>, accessed 2 December 2020.

⁶⁶ <https://www.msci.com/index-carbon-footprint-metrics>, accessed 2 December 2020.

Table 3: Contribution to weighted average carbon intensity of the S&P/ASX200

	Index weight	Contribution to Weighted Average Carbon Intensity
Materials	20.04%	50.21%
Utilities	1.71%	17.26%
Energy	3.42%	12.92%
Industrials	7.68%	5.75%
Real Estate	7.04%	3.49%
Information Technology	4.04%	2.79%
Consumer Discretionary	7.55%	2.20%
Health Care	12.30%	2.10%
Consumer Staples	6.32%	1.91%
Communication Services	4.05%	0.82%
Financials	25.86%	0.56%

As at 30 September 2020. Source: S&P Dow Jones

The relatively small size and concentration of the S&P/ASX200 provides limited opportunity to reduce carbon intensity through stock selection within the same sector. For example, as at 30 September 2020, there were only four companies in the S&P/ASX200 Utilities sector, thus making it difficult for investors to switch out of the most emissions intensive company in the entire index, AGL Energy. This is less of an issue for international equities portfolios, as the larger number of companies and geographical representation in global benchmarks, such as the MSCI All Countries World Index (ACWI), provide greater opportunity to reduce carbon intensity through stock selection.

Australian superannuation funds with approximately similar exposure to Australian and international equities can significantly reduce their overall carbon intensity by shifting to a low carbon benchmark in the passive component of their international equities portfolio. Reducing carbon intensity in Australian equities portfolios is likely to prove more difficult.

Aware Super, upon announcing its suite of climate targets in July 2020, set a target of “a minimum 30% reduction in emissions in [its] listed equities portfolio by 2023, which will also incorporate the introduction of a new low-carbon index”.⁶⁷ This was clarified in its announcement of a 40 per cent reduction in the carbon footprint of its equities holdings “virtually overnight” in November 2020,⁶⁸ through the divestment of 60 companies globally, including nine in Australia. Aware Super declined to name the companies it divested.

⁶⁷ <https://aware.com.au/blog/divesting-from-thermal-coal.html>, accessed 27 November 2020.

⁶⁸ James Fernyhough, “Aware Super Nearly Halves Emissions in Mass Divestment”, *Australian Financial Review*, November 2020.

Superannuation funds have a responsibility to members to be transparent about what reducing carbon exposure means in practice, and what it may or may not mean for emissions reductions in the real economy and their engagement with listed companies. Where divestment is likely to reduce exposure, but have limited or no impact on emissions in the real economy and potentially put engagement outcomes further out of reach, funds should speak clearly about this.

While carbon exposure metrics are a useful tool for measuring and managing the transition risks from climate change in a listed equities portfolio, several issues arise in attaching targets to such metrics, primarily relating to data reliability and sufficiency.

ACCR assessed the appropriateness of using carbon exposure metrics to assess the transition risk faced by the 25 largest emitters in the S&P/ASX200 index. The 25 largest emitting companies in the S&P/ASX200 index constitute 26.6% of the index weight, but 72.8% of the Weighted Average Carbon Intensity (metric tons CO₂e/USD 1 million revenues).

We found that the carbon exposure metrics defined in Section 6 are insufficient for managing the breadth of transition risks faced by Australian listed companies.

We recommend that investors ask the following questions before setting targets based on carbon exposure metrics:

- Is the emissions data reliable?
- What are the company's Scope 3 emissions?
- What are the company's short- and medium-term plans?
- Has the company achieved real world emissions reductions?

7.1 Is the emissions data reliable?

In Australia, listed companies are not legally required to disclose their greenhouse gas emissions in their annual reports. Corporate groups emitting more than 50,000 tonnes of CO₂-e emissions (Scope 1 and Scope 2) are required to report to the Clean Energy Regulator, and this data is then disclosed to the general public in the March following the end of the financial year (30 June).⁶⁹ However, due to complex corporate structures, many listed companies have multiple entities in the Clean Energy Regulator dataset, particularly joint ventures or where a company does not have operational control. Rio Tinto, for example, has at least five different entities in the Clean Energy Regulator dataset, including joint ventures.⁷⁰ For this reason, company disclosures remain the single most important source of accurate and timely emissions data.

According to the Australian Council of Superannuation Investors (ACSI), just 60% of S&P/ASX200 companies disclose all their operational emissions (Scope 1 and 2).⁷¹

ACCR found that the 25 largest emitters in the S&P/ASX200 all disclose their operational emissions (Table 4). However, several companies do not disclose emissions data for the same period as their financial reporting, including Alumina, BlueScope Steel and Santos. Best practice disclosure of emissions should be consistent with financial reporting, and include a breakdown by commodity or business, allowing for a better understanding of the progress of each business unit or facility over time. Such disclosure is currently the exception rather than the norm.

In the absence of company disclosures, index providers such as S&P use estimates, typically based on the sector in which a company operates.⁷² This lack of accurate and timely data from all companies within an index must be considered when investors are deciding to reduce their exposure to specific companies or sectors.

This issue would be best addressed by the introduction of a legal requirement for companies to provide accurate, timely and audited emissions disclosure, and accompanied by fines for non-compliance. In the absence of regulatory reform, investors should thoroughly interrogate company level data and seek to fill gaps.

⁶⁹ Clean Energy Regulator, “Corporate Emissions and Energy Data 2018–19”, March 2020.

⁷⁰ *ibid.*

⁷¹ Australian Council of Superannuation Investors, “Promises, Pathways and Performance - Climate Change Disclosure in the ASX200”, October 2020, p5.

⁷² S&P Dow Jones Indices LLC, “Index Carbon Metrics Explained”, 2020.

7.2 What are the company's Scope 3 emissions?

Arguably, the most significant problem with carbon exposure metrics is the exclusion of Scope 3 emissions (value chain emissions). The carbon exposure metrics defined in Section 6 do not include Scope 3 emissions, and currently there is no standard metric applied to listed companies that captures Scope 3 emissions. In 2019, ACSI found that just 57 out of the S&P/ASX200 companies, or 28.5%, disclosed Scope 3 emissions.⁷³ Disclosure of Scope 3 emissions by the largest emitters in the S&P/ASX200 index is better than the broader index, which is likely due to greater investor scrutiny around climate risk disclosure at those companies.

ACCR found that 20 of the 25 largest emitters in the S&P/ASX200 disclose some Scope 3 emissions data (Table 4). 13 companies have significantly higher Scope 3 emissions than their operational emissions. Whitehaven Coal does not disclose its Scope 3 emissions, but they are likely to be much greater than its operational emissions.

For companies involved in the fossil fuel supply chain, Scope 3 emissions typically dwarf their operational emissions. For example, Santos and Woodside Petroleum's Scope 3 emissions are approximately four times the size of their operational emissions,⁷⁴ while BHP's Scope 3 emissions are more than 35 times the size of its operational emissions.⁷⁵

Investors that disregard Scope 3 emissions may remain exposed to significant transition risk. Some companies taking active steps to reduce their operational emissions are also increasing fossil fuel production. Recently, Santos and Woodside Petroleum committed to reduce their operational emissions by 26-30% and 30% by 2030,⁷⁶ respectively. Both companies plan to achieve this through a combination of carbon offsets, energy efficiency and carbon capture and storage. However, both companies are also planning to significantly increase gas production over the same timeframe, and have avoided setting Scope 3 targets.

It is also worth noting the issue of 'financed emissions,' that is, the carbon exposure of companies in the financial services sector. While an analysis of financed emissions profiles of ASX-listed financial services companies is beyond the scope of this report, asset managers, banks and insurers are likely to be exposed to carbon emissions an order of magnitude greater than their own operational emissions. These emissions are also not captured by carbon exposure metrics.

⁷³ Australian Council of Superannuation Investors, "ESG Reporting by the ASX200", August 2019, p18.

⁷⁴ Santos, "2020 Climate Change Report," February 2020, p41; Woodside Petroleum, "Data Tables GRI and IPIECA Indices", February 2020, p3.

⁷⁵ BHP, "BHP Climate Change Report 2020", September 2020, p23-28.

⁷⁶ Santos, "Santos 2020 Investor Day", December 2020, p14; Woodside Petroleum, "Investor Briefing Day 2020", November 2020, p16.

Table 4: Emissions performance

Company	Change in operational emissions, last three years available (tonnes CO ₂ -e)	% Change	Annual Scope 3 emissions (tonnes CO ₂ -e)
AGL Energy Ltd	43.36M → 42.25M	-2.54%	25,700,000
Rio Tinto Ltd	30.6M → 26.4M	-13.73%	491,000,000
South32 Ltd	22.8M → 23.3M	2.19%	110,000,000
Origin Energy Ltd	20.25M → 18.47M	-8.81%	27,451,000
BHP Group Ltd	17M → 15.8M	-7.06%	563,000,000
Qantas Airways Ltd	12.53M → 9.36M	-25.27%	882,401
Bluescope Steel Ltd	10.75M → 10.28M	-4.37%	13,300,000
Santos Ltd	6.13M → 6.36M	3.75%	24,500,000
Alumina Ltd	11.32M → 12.54M	10.81%	37,289,281
Woodside Petroleum Ltd	9.89M → 8.84M	-10.62%	27,900,000
Incitec Pivot	3.75M → 3.4M	-9.37%	83,980
CIMIC Group Ltd	2.33M → 2.76M	18.28%	1,143,000
Woolworths Group Ltd	2.9M → 2.42M	-16.27%	348,362
Boral Ltd	2.6M → 2.22M	-14.30%	3,100,000
Adbri Ltd	2.44M → 2.39M	-2.19%	Not disclosed
Orica Ltd	2.5M → 2.11M	-15.65%	4,155,000
Newcrest Mining Ltd	2.15M → 2.27M	5.86%	602,108
Fortescue Metals Group	1.67M → 2.09M	25.15%	244,500,000
Ausnet Services Ltd	2.05M → 1.6M	-21.63%	Not disclosed
Amtor Plc	1.59M → 2.05M	29.13%	9,946,570
Coles Group Ltd	1.72M → 1.6M	-7.26%	275,640
Wesfarmers Ltd	1.44M → 1.6M	11.56%	24,646,225
Whitehaven Coal Ltd	1.35M → 1.61M	19.48%	Not disclosed
Viva Energy Group Ltd	1.33M → 1.43M	7.68%	Not disclosed
APA Group	1.61M → 1.4M	-12.68%	4,045

Source: Company reporting data is from FY18-20, with the exception of Alumina, CIMIC Group, Rio Tinto and Woodside Petroleum which is from 2017-19, and, Adbri, APA Group, Ausnet Services, BlueScope Steel, Incitec Pivot, Santos, VIVA Energy and Whitehaven Coal which is from FY17-19.

Note: Scope 3 emissions data from APA Group and Incitec Pivot relates to air travel and shipping only, respectively.

7.3 What are the company’s short- and medium-term plans?

Carbon exposure metrics are, by their nature, based on historical data, and do not necessarily reflect forward-facing business strategies. There may be companies with ambitious short-to medium-term emissions reduction commitments with relatively poor carbon exposure metrics. By contrast, a falling trend in historical emissions, particularly as a result of COVID-19, may have little relation to the future climate impact of a fossil fuel company with aggressive expansion plans.

Two pillars of the TCFD framework—scenario analysis, and metrics and targets—were designed to give investors clarity around a company’s resilience to the various aspects of climate risk. Neither of these forward-looking disclosure categories are captured by carbon exposure metrics.

ACSI found that just 37% of S&P/ASX200 companies have set emissions reduction targets, “with a noticeable shortage of medium and long-term aims”.⁷⁷ Furthermore, ACSI identified just 28 companies with medium term targets (to 2026-2039) and 13 companies with long term targets (to 2040 and beyond).⁷⁸

ACCR’s analysis of the 25 largest emitters in the S&P/ASX200 found that:

- Nine companies have short-term targets to reduce emissions by 2025 or sooner. Five of these are “intensity” targets (reductions in emissions per unit of production), while three of the nine companies have set short-term targets that require absolute emission reductions. One company, Wesfarmers, has separate short-term targets for its subsidiaries which includes both intensity and absolute targets.
- Ten companies have set medium-term emissions reduction targets by 2030. Three of these are intensity targets and six require absolute emission reductions. Additionally, Rio Tinto has set both an intensity and absolute medium-term emissions target for 2030.
- Ten companies have set net-zero emissions targets by 2050, and one company, Woodside, has an “aspirational” target of net-zero by 2050. None of these net-zero commitments include Scope 3 emissions.
- Five companies have set targets related to their Scope 3 emissions: Amcor, BHP, Boral, Origin Energy and Woolworths. Two of those companies are involved in fossil fuel extraction—BHP and Origin Energy—but neither has committed to reducing fossil fuel production.
- Two companies have emissions reduction targets certified by the Science-Based Targets Initiative (SBTi): Origin Energy’s target is aligned to a 2°C pathway and Woolworths’ target is aligned to a 1.5°C pathway. BHP is currently seeking SBTi certification.

⁷⁷ Australian Council of Superannuation Investors, “Promises, Pathways and Performance - Climate Change Disclosure in the ASX200”, October 2020, p5.

⁷⁸ *ibid.*

- Four companies have not set any emissions reduction targets at all: APA Group, Ausnet Services, Viva Energy and Whitehaven Coal.

There has been a spate of new emissions reduction targets announced by Australian listed companies in 2020, particularly commitments to net-zero by 2050. Investors must ensure that these long-term targets are complemented by ambitious short- and medium-term targets.

Table 5: Emissions targets

Company	Short-term targets Scope 1 + 2, to 2025	Mid-term targets Scope 1 + 2, to 2030	Long-term targets Scope 1 + 2, after 2030	Scope 3 emissions
AGL Energy Ltd	No target, but the planned closure of Liddell in 2022-23 implies a 18-20% reduction on 2020 operational emissions.	None	Net-zero by 2050; planned closure of Bayswater in 2035 and Loy Yang A in 2048.	None
Rio Tinto Ltd	Reduce emissions intensity by 24% between 2008 and 2020.	Reduce emissions intensity by 30% and reduce absolute emissions by 15% by 2030 (2018 equity baseline, adjusted for divestments).	Net-zero by 2050.	None
South32 Ltd	Maintain Scope 1 emissions below FY15 baseline (11.2mt) to FY21.	None	Net-zero by 2050.	None
Origin Energy Ltd	Reduce Scope 1 emissions by 10% on average between FY21 and FY23 (2017 baseline). Renewables and storage to make up more than 25% of generation mix by 2020.	None	Net-zero emissions by 2050; reduce operational emissions 50% by 2032 (2017 baseline).	Reduce Scope 3 emissions by 25% by 2032 (2017 baseline)
BHP Group Ltd	Maintain operational emissions at or below FY17 levels by FY22.	Reduce operational emissions by at least 30% by 2030 (2020 baseline).	Net-zero by 2050.	Reduce emissions intensity of steelmaking customers (Scope 3) 30% by 2030 (2020 baseline). Reduce emissions intensity of BHP-chartered shipping products (Scope 3) 40% by 2030 (2020 baseline).
Qantas Airways Ltd	Cap emissions at 2019 levels. 1.5% average annual fuel efficiency improvement.	Cap emissions at 2019 levels.	Net-zero by 2050.	None
Bluescope Steel Ltd	None	Reduce emissions intensity in steelmaking sites by 12% by 2030 (2018 baseline).	None	None

Company	Short-term targets Scope 1 + 2, to 2025	Mid-term targets Scope 1 + 2, to 2030	Long-term targets Scope 1 + 2, after 2030	Scope 3 emissions
Santos Ltd	Reduce operational emissions in QLD and SA by 5% by 2025 (2018 baseline).	Reduce emissions by 26–30% by 2030 (2020 baseline).	Net-zero by 2040.	None
Alumina Ltd	Alcoa: (60% share) Reduce emissions intensity by 30% by 2025 (2015 baseline). AWAC: Reduce emissions intensity by 4% by 2025 (2015 baseline).	Alcoa: Reduce emissions intensity by 50% by 2030 (2015 baseline). AWAC: Reduce emissions intensity by 12% by 2030 (2015 baseline).	None	None
Woodside Petroleum Ltd	Reduce operational emissions by 15% by 2025 (Avg 2016–20 baseline, equity share only).	Reduce operational emissions by 30% by 2030 (Avg 2016–20 baseline, equity share only).	Aspiration to be net-zero by 2050.	None
Incitec Pivot	Annual setting of intensity targets: baseline set in 2015 for CO2 emissions from ammonia and nitric acid production.	Reduce emissions by 5% by 2026 (baseline 2020).	None	None
CIMIC Group Ltd	ACS GROUP (parent): reduce emissions intensity below 2015 levels by 2020.	None	None	None
Woolworths Group Ltd	Source 100% renewable electricity by 2025.	Reduce operational emissions by 63% by 2030 (2015 baseline).	Net-zero by 2050.	Reduce Scope 3 emissions by 19% by 2030 (2015 baseline).
Boral Ltd	Reduce emissions intensity by 10–20% by 2023 (baseline 2018). Increase share of revenue from lower carbon, high-recycled-content products.	None	None	Reduce Scope 3 emissions by 1.1–1.5 million tonnes by increasing fly ash supply by 2022.
Adbri Ltd	Reduce operational emissions by 7% by 2025 (2019 baseline).	None	None	None
Orica Ltd	Reduce emissions intensity to less than 1.7 tCO2e/tonne ammonium nitrate sold by 2022.	Reduce operational emissions by 40% by 2030 (2019 baseline).	None	None
Newcrest Mining Ltd	None	Reduce emissions intensity by 30% by 2030 (2018 baseline).	None	None

Table 5: Emissions Targets

Company	Short-term targets Scope 1 + 2, to 2025	Mid-term targets Scope 1 + 2, to 2030	Long-term targets Scope 1 + 2, after 2030	Scope 3 emissions
Fortescue Metals Group	Reduce emissions intensity in electricity generation by 25% by 2020 (2015 baseline). Reduce emissions intensity in electricity consumption in the production process by 5% (2017 baseline).	Reduce operational emissions by 26% by 2030 (2020 baseline).	Net-zero operational emissions by 2040.	None
Ausnet Services Ltd	None	None	None	None
Amcor PLC	Reduce emissions intensity by 18% by 2025 (2006 baseline).	Reduce emissions intensity by 60% by 2030 (2006 baseline).	None	Reduce emissions intensity by 60% by 2030 (2006 baseline).
Coles Group Ltd	Source 10% of electricity from renewable sources by 2021. Source 90% renewable electricity for QLD operations by 2024.	None	None	None
Wesfarmers Ltd	<p>Bunnings: Reduce operational emissions by 10% by 2025 (2018 baseline).</p> <p>Kmart: Reduce operational emissions by 20% by 2025 (2018 baseline).</p> <p>Officeworks: Reduce operational emissions by 25% by 2025 (2018 baseline).</p> <p>WesCEF: Maintain emissions intensity below peers by 2025 (2018 baseline).</p> <p>Industrial and Safety: Reduce operational emissions by 12% by 2025 (2018 baseline).</p> <p>Coregas: Maintain emissions intensity below peers by 2025 (2018 baseline).</p>	<p>Bunnings: Net-zero by 2030.</p> <p>Kmart: Net-zero by 2030.</p> <p>Officeworks: Net-zero by 2030.</p>	<p>WesCEF: Net-zero aspiration by 2050.</p> <p>Industrial and Safety: Net-zero by 2050.</p> <p>Coregas: Net-zero aspiration by 2050.</p>	None
Whitehaven Coal Ltd	None	None	None	None
Viva Energy Group Ltd	None	None	None	None
APA Group	None	None	None	None

Table 5: Emissions Targets

7.4 Has the company achieved real world emissions reductions?

In recent years, several Australian listed companies have reported declines in operational emissions that have come about through the divestment of assets or changes to their supply chains. Crucially, however, these have not resulted in emissions reductions in the real economy. We explore some of these examples below, with a view to informing decision-making around how emissions reductions are achieved in listed equities portfolios.

Corporate asset-level divestment

Rio Tinto sold its NSW coal mines to Yancoal in 2017, and its Queensland coal mines to Glencore, EMR Capital and Adaro Energy in 2018.⁷⁹ In its 2019 climate change report, Rio Tinto declared that it had “reduced the absolute emissions from [its] managed operations by 46%” since 2008.⁸⁰ Excluding the divestment of its coal assets, Rio Tinto only reduced its operational emissions by 18% between 2008 and 2019.⁸¹ Crucially, each of the operating coal mines sold by Rio Tinto continue to produce coal. In the case of the Valeria coal mine, Glencore is seeking approval from the Queensland government to commence production by 2026.⁸²

Similarly, BHP Group spun off numerous emissions-intensive assets into South32 in 2015,⁸³ then divested its onshore US oil and gas assets in 2018.⁸⁴ Largely because of these divestments, BHP’s absolute emissions declined from 45 million tonnes CO₂e in FY14 to 15.8 million tonnes CO₂e in FY20.⁸⁵ The assets divested by BHP in 2015 and 2018 continue to produce carbon emissions today.

Following sustained pressure from institutional investors, in August 2020, BHP CEO Mike Henry announced that BHP would divest its remaining thermal coal mines—Cerrejón in Colombia and Mt Arthur in NSW (Australia)—within two years.⁸⁶ BHP also committed to divesting its 50% stake in the BHP-Mitsui metallurgical coal joint venture, and its 50% stake in oil and gas fields off the coast of Victoria.⁸⁷ While these additional divestments will likely improve BHP’s carbon exposure metrics, the carbon emissions do not simply disappear.

A different, if tentative, approach has recently been advanced by outgoing Glencore CEO Ivan Glasenberg, who has criticised the push to divest coal assets, suggesting that they could end up in “the

⁷⁹ Stephanie Chalmers, “Rio Tinto Completes Its Exit from Coal”, ABC News, March 2018.

⁸⁰ Rio Tinto, “Our Approach to Climate Change”, February 2020, p3.

⁸¹ *ibid.*

⁸² Glencore, “Glencore’s Valeria Coal Project in Queensland”, June 2020.

⁸³ BHP Billiton, “Demerger of South32 Unlocks Shareholder Value”, March 2015.

⁸⁴ BHP Billiton, “BHP Completes Sale of Onshore US Assets”, November 2018.

⁸⁵ BHP, “BHP Climate Change Report 2020”, September 2020, p22.

⁸⁶ Nick Toscano, “BHP Seeks Buyers for Coal Mines, Oil Fields in Portfolio Shake-Up”, *The Sydney Morning Herald*, August 2020.

⁸⁷ *ibid.*

hands of other players who have no intention of reducing Scope 3 emissions and if anything gives them a free hand to start producing more”.⁸⁸ At face value, these comments suggest that Glencore may be prepared to begin winding up fossil fuel producing assets, rather than divest them, to reduce its Scope 3 emissions. If matched with action in the near term, this would be a welcome development.

Companies may also be motivated to divest fossil fuel assets as they near end-of-life to avoid the costs and complexities of a “just transition”⁸⁹ for workers, as well as significant rehabilitation costs. Long term investors should be sensitive to the need to avoid scenarios where scrutiny of a company’s Scope 3 profile results in abrupt divestment of an asset to a buyer of last resort that is disinterested in emissions reduction, workforce transition, responsible decommissioning or environmental remediation. Recent months provide a case in point: the Australian Government has been forced to cover the cost of decommissioning for the Northern Endeavour oil platform, which was operated by Woodside between 1999 and 2016.⁹⁰ Woodside paid \$24 million to Northern Oil and Gas Australia (NOGA) to take over the site, but NOGA subsequently entered voluntary administration in late 2019.⁹¹

IIGCC’s Net Zero Investment Framework (Section 5) recommends investors vote against mergers and acquisitions (M&A) where the post M&A company cannot meet the same expectations of emissions reductions.⁹²

Changes to supply chains

In 2012, Boral announced that it would cease manufacturing clinker—a key ingredient in cement production—at its Blue Circle Southern Cement plant in Victoria.⁹³ Then CEO, Mike Kane, said at the time that the combination of a high Australian dollar, low shipping costs and the increased cost of local manufacturing made importing clinker relatively cheaper than manufacturing it locally.⁹⁴ In FY2020, Boral’s clinker manufacturing operations in Australia accounted for 45% of its total Scope 1 and 2 emissions,⁹⁵ producing 70% of Boral’s clinker, while the remaining 30% was imported. Since FY2005, Boral has reduced its Scope 1 and 2 emissions in Australia by approximately 44%.⁹⁶ Boral

⁸⁸ Neil Hume and Henry Sanderson, “Glencore’s Glasenberg Dismisses Coal Divestment as Pointless”, *Financial Times*, October 2020.

⁸⁹ Australian Council of Trade Unions, “The Need for a Just Transition”, accessed December 2, 2020.

⁹⁰ Adam Morton, “Calls for Woodside to pay \$200m to clean up moribund Timor Sea oil site it ran until 2016”, *The Guardian*, 9 August 2020.

⁹¹ *ibid.*

⁹² The Institutional Investors Group on Climate Change, “Net Zero Investment Framework for Consultation”, August 2020, p28.

⁹³ Boral, “Boral Plans Suspension of Clinker Production at Its Waurin Ponds Cement Plant in Victoria”, December 2012.

⁹⁴ *ibid.*

⁹⁵ Boral, “Annual Report 2020”, September 2020, p32.

⁹⁶ Boral, “2020 Boral Review & Sustainability Report”, September 2020, p34.

admits that it “achieved this largely by realigning [its] portfolio away from emissions-intensive businesses and reducing clinker manufacturing in Australia”.⁹⁷

In FY2020, Boral’s Scope 3 emissions were 3.1 million tonnes CO₂e and its operational emissions were 2.2 million tonnes.⁹⁸ While Boral’s disclosure of its operational emissions is quite comprehensive (providing seven years’ worth of data), the company only disclosed its Scope 3 emissions for the first time in its FY2019 reporting.⁹⁹ This lack of data prevents any analysis of the impact of offshoring clinker production.

Closure of old facilities

At the end of March 2017, French company ENGIE closed its majority-owned Hazelwood coal-fired power station in Victoria, after just five months’ notice.¹⁰⁰ ENGIE cited lower electricity prices and a surplus of electricity supply as the reasons for its closure. While ENGIE was not a member of the S&P/ASX200 index, the closure of Hazelwood had a significant impact on the index’s carbon intensity.

In FY2016, Hazelwood produced more than 10.3 GWh of electricity and 14.6 million tonnes of CO₂e emissions.¹⁰¹ Hazelwood’s relatively abrupt departure from the National Electricity Market (NEM) required other carbon intensive generators to increase their output, including AGL Energy and Origin Energy. So, while the closure of a brown coal-fired power station was a positive step for climate action, the consequence was increased output and therefore emissions from at least two ASX-listed companies.

Three years after the closure of Hazelwood, Origin Energy estimated that the closure resulted in its Scope 1 equity emissions increasing by more than 1 million tonnes CO₂e in FY2018 and FY2019, as it “supported the market with [its] thermal generation fleet” to “ensure security of supply.”¹⁰²

Changes in market dynamics are not uncommon, and there may be future scenarios where a large power station or industrial facility undergoes a planned or unplanned temporary closure that results in competitors increasing production. Such incidents, while temporary, may affect the carbon exposure metrics of multiple market participants.

⁹⁷ *ibid.*

⁹⁸ *ibid.*

⁹⁹ Boral, “2019 Boral Review”, September 2019, p39.

¹⁰⁰ ENGIE, “Hazelwood Power Station in Australia to Close at the End of March 2017”, November 2016.

¹⁰¹ Clean Energy Regulator, “Electricity Sector Emissions and Generation Data 2015–16”, November 2018.

¹⁰² Origin Energy, “2020 Sustainability Report”, August 2020, p14.

8. Implications for engagement

Investors can, through carbon exposure metrics driving divestment and reallocation strategies, reduce the emissions intensity of their listed equities portfolios without having any direct or immediate impact on emissions in the real economy. As above, this is concerning in itself, but risks can be mitigated where company engagement practices and initiatives respond forcefully and with a clear and transparent strategy to address systemic risk.

However, in this section we raise a further concern: the potential for conflict, within a fund or a collaborative engagement initiative, between divestment/reallocation behaviour and engagement activity, particularly where a divestment decision is taken in circumstances where engagement behaviour has been non-exhaustive. It is crucial that participants in collaborative engagement strategies grapple with these conflicts.

Key questions include:

- Where, for instance, a participant in the Climate Action 100+ initiative divests or substantially sells down a stock for which it has responsibility as ‘lead’ or ‘support’ engager, what are the implications for CA100’s ongoing engagement with that company?
- What engagement and escalation tools should peer collaborative engagement participants expect a ‘responsible divester’ to have deployed before taking such a decision?
- Are there shareholder strategies, particularly legal avenues, that can and should be explored post-divestment?
- Should divestment by a fund with collaborative engagement responsibility for a company be read as evidence that successful engagement with that company is unlikely? If so, shouldn’t that be disclosed to the rest of the initiative and indeed other stakeholders relying on engagement strategies to drive down real world emissions?

These are not merely hypothetical concerns. The broad and increasing uptake of intensity metrics by CA100 participant funds implies widespread divestment and reallocation activity by those same funds.

Funds tend to be guarded about these decisions. We have been reliably informed of a handful of examples where divestment or substantial downselling has, or is likely to have, happened among lead CA100 engagers, but have as at the date of publication been unable to confirm these decisions on publicly available material.

According to the NZAOA, “transformation in the real economy is a must if we are to reach the ambitions set in the Paris Agreement... Holding a large proportion of low-carbon assets or divesting out of high-emitting ones will not be enough”.¹⁰³ For universal owners such as superannuation funds,

¹⁰³ U.N.-convened Net-Zero Asset Owner Alliance, “Draft 2025 Target Setting Protocol”, October 2020, p16.

reducing the carbon intensity of portfolios must be complemented by a focus on reducing emissions in the real economy (the position of passive asset managers will be considered in a subsequent report). Furthermore, they must ensure that companies are actually reducing emissions rather than simply divesting emissions intensive businesses or shifting emissions up their supply chain. Low or declining emissions intensity may give clients and beneficiaries a potentially inaccurate impression that fund strategy is driving declining emissions in the real economy, and that the entirety of climate risk is being managed effectively. Transparency will be critical to ensure ease of comparison and accountability for decisions made.

NZAOA states that engagement is “the mechanism through which the impact on real world emissions is most likely to materialise”,¹⁰⁴ but implies that investors should be willing to provide the necessary capital for the transition “so long as the sector activities are transformable to a net-zero economy”. In Australia, numerous investors have concluded that companies involved in the extraction and combustion of thermal coal fit the criteria for divestment, as outlined in Section 5. While NZAOA argues that “there is currently limited empirical evidence to support a divestment beyond coal and distressed segments of the oil and gas sector”,¹⁰⁵ some investors have already decided that broad divestment from the oil and gas sector is warranted.

Investors seeking to reduce their emissions intensity through divestment or selling down must consider the implications for their engagement practices and avoid the false economies of reduced portfolio intensity.

8.1 Transparency around divestment and escalation

As outlined in Section 5, many ethical and some mainstream investors have been divested from companies materially involved in thermal coal mining for several years. In 2020, several Australian funds announced their divestment from two widely held, Australian thermal coal companies, New Hope Group and Whitehaven Coal. However, none of the funds that announced their divestment from these companies in 2020 had disclosed their reasoning or timeline for doing so, prior to divestment. Notably, for the last three years, remuneration reports and the re-election of directors at both companies were passed with an average of 98% shareholder support.¹⁰⁶ This level of support suggests that either investor discontent with the strategy of the two companies is very recent, or that discontent did not translate into voting behaviour—a key company engagement and escalation tool—over that timeframe. In our assessment, the latter is substantially more likely, and speaks to a failure of institutional investors to fully comprehend the levers of engagement and escalation available to drive company decarbonisation.

¹⁰⁴ *ibid.*

¹⁰⁵ *ibid.*, p17.

¹⁰⁶ New Hope Corporation Ltd and Whitehaven Coal Ltd, AGM Results, 2018-20.

Of the superannuation funds that announced divestment from thermal coal companies in 2020, none publicly declared their intentions prior to divestment. Arguably, one of the most important aspects of divestment is the signalling to other companies and investors. If divestment affords power, one of its key components was not utilised. To date, divestment decisions by Australian investors have not had as much impact as they could have had, had they been transparent about the conditions which would result in an escalation to divestment, prior to the act itself.

Those investors that have set short- or medium-term emissions reduction targets for their entire portfolios are unlikely to achieve equivalent emissions reductions across all asset classes. As discussed in Section 5, Aware Super was able to reduce the emissions intensity of its equities portfolio by 40% virtually overnight.¹⁰⁷ It is unlikely to achieve this outcome in its infrastructure or property portfolios as quickly. If the reduction in carbon exposure in listed equities portfolios is likely to be greater than that achieved in other asset classes, then it implies an even greater inconsistency with companies that have yet to set ambitious targets for 2030 or sooner. AGL Energy, for instance, does not intend to close its remaining two coal-fired power stations until 2035 and 2048.¹⁰⁸ For investors that have set themselves targets for 2030, AGL Energy may simply become uninvestable.

8.2 Escalation

Beyond private conversations, the IIGCC Net-zero Investment Framework (Section 5), suggests the following pathways for escalation, where engagement has failed to deliver an outcome over several years:¹⁰⁹

- voting against the board, remuneration policy or annual report and accounts if the company is not on track to achieve its plan and targets for a period of two or more years;
- voting against Mergers & Acquisitions (M&A) unless the post M&A company meets or can be expected to meet targets within a reasonable period; and/or
- co-filing and/or supporting shareholder resolutions.

While there has been increasing support for shareholder resolutions in Australia in recent years,¹¹⁰ few institutional investors have co-filed resolutions, and no Australian institutional investor has filed a resolution itself. This is despite mounting evidence that shareholder resolutions are a powerful tool to elicit shifts in company behaviour: recent analysis by BlackRock shows that “[w]here a shareholder

¹⁰⁷ James Fernyhough, “Aware Super Nearly Halves Emissions in Mass Divestment”, *Australian Financial Review*, November 2020.

¹⁰⁸ AGL Energy, “Pathways to 2050, FY20 TCFD Report”, June 2020, p25.

¹⁰⁹ The Institutional Investors Group on Climate Change, “Net Zero Investment Framework for Consultation”, August 2020, p28.

¹¹⁰ Australasian Centre for Corporate Responsibility (ACCR), “Two Steps Forward, One Step Back”, June 2020.

proposal received 30% to 50% support the company fully or partially met the request of the proposal 67% of the time.”¹¹¹

ACSI’s comprehensive analysis of climate commitments by companies in the S&P/ASX200 index found that while climate risk disclosure is steadily improving, emissions reduction targets aligned with the Paris Agreement are limited.¹¹²

ACCR’s analysis of the 25 largest emitters in the S&P/ASX200 suggests that investors could focus their attention on a relatively small number of companies to achieve significant change. Investors must be willing to engage forcefully, using all the tools available to them, in order to drive change within listed companies.

The climate commitments made to date by various Australian investors suggest that there is a vast discrepancy between their own commitments and those of the largest emitters in the S&P/ASX200. The current commitments by many of Australia’s most carbon intensive companies, including AGL Energy, Rio Tinto, South32 and others, are inconsistent with those of a growing number of investors, who are likely to divest from those companies unless their commitments are sufficiently ratcheted up in the near term.

8.3 Climate solutions

The IIGCC Net-zero Investment Framework (Section 5) recommends investors set a goal for the allocation of a percentage of assets under management or revenues to climate solutions.¹¹³ Similarly, the Divest-Invest movement suggests investors that divest from fossil fuels reallocate the funds to climate solutions, rather than simply reallocate the capital to existing shareholdings.

To date, there is little evidence to suggest that Australian investors that have divested from fossil fuel companies have reallocated those funds to climate solutions. While many funds have invested in renewable energy, energy efficiency and energy storage solutions, these decisions appear to be made independently of divestment from fossil fuels.

Following its divestment in November 2020, Aware Super announced a \$30 million investment into battery storage hubs in New York City,¹¹⁴ but it is not clear that this was a direct reallocation of the proceeds from its listed equities divestment.

¹¹¹ BlackRock, “Our 2021 Stewardship Expectations Global Principles and Market-Level Voting Guidelines”, December 2020, p5.

¹¹² Australian Council of Superannuation Investors, “Promises, Pathways and Performance - Climate Change Disclosure in the ASX200”, October 2020, p5.

¹¹³ The Institutional Investors Group on Climate Change, “Net Zero Investment Framework for Consultation”, August 2020, pp12–13.

¹¹⁴ Aware Super, “Under-utilised New York City real estate converted into battery storage hubs”, 7 December 2020

Some funds may be limited by their strategic asset allocation, which would restrict how much capital could be reallocated from listed equities to infrastructure or property, for instance. Some investors may choose to reallocate capital to other listed companies that prioritise climate solutions, be they renewable energy utilities, electric vehicle manufacturers or mining companies extracting minerals required for zero-emissions technologies. Investors must consider what happens beyond divestment. Investment in climate solutions is not prescriptive, and there are myriad opportunities for investors to promote climate action.